TESTIMONY

THE HOUSE BANKING SUBCOMMITTEE ON CAPITAL MARKETS, SECURITIES AND GOVERNMENT SPONSORED ENTERPRISES

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Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to speak with you about H.R. 3637, the Children's Development Commission Act. To my knowledge, this is the first bill of any substance to address the overwhelming need for an organized response to the crisis in child care facility finance and development that exists in many parts of the country. Such a commission will be able to help support a coherent system of early childhood development in the United States, even while supporting states in their individual efforts to respond to the needs and desires of all families.

The Illinois Facilities Fund is a statewide nonprofit community development financial institution created in 1988 by a foundation to make below-market loans to nonprofits unable to obtain conventional financing. The IFF also undertakes real estate development for nonprofits. While we work with nonprofit agencies in many fields, we have an expertise in child care. In addition to lending and consulting on real estate projects, we financed, constructed and own seven large child care centers in five Illinois cities, through a program we designed in partnership with the State of Illinois. We are managing the construction of two additional child care centers in Chicago, which will break ground this summer, partly funded with Empowerment Zone funds and focused on supporting the goals of welfare reform. These buildings will both create jobs and enable parents to accept employment.

The majority of our work is in disinvested or low-income neighborhoods, because these are the communities in which banks are more hesitant to lend, generally due to low real estate values.

The IFF is a founder of the National Children's Facilities Network, a group of nonprofit organizations similar to the IFF, which tracks state and federal policy with regard to capital investment in the child care field, and encourages better financial planning. In Illinois, the IFF is involved in research and policy activities to improve planning for child care and to increase funding and operating flexibility. The IFF provides consulting to government entities and nonprofit agencies on planning, the financial feasibility of real estate projects, and on the construction, operations and funding of buildings for new or growing programs.

Child care has recently become a visible and integral part of American life as women of all ages and incomes continue to seek full time or part time employment. In addition, there is a growing realization that appropriate early childhood development is absolutely critical in every child's life. Child care is more than a support service to enable parents to work; early childhood development determines whether children are developmentally prepared for kindergarten. For these reasons, there is tremendous pressure on the child care field to grow. While many families have child care choices with little or no financial constraint, parent behavior shows that there is a limit to the amount that will be paid for this care, no matter what the family income. It is generally agreed by child care advocates and observers of the economics of the field that no family should pay more than 10 percent of the family income for child care. As with so many other services, higher income families actually pay a smaller percentage of their incomes for child care than lower income families pay.

Studies show that 32% of all parents using out-of-home care for their pre-schoolers choose or want to choose a child care center. Further, studies show that a majority of parents using out of home care for children older than age two choose or want to choose center based care, because it is believed that centers provide socialization and education more consistently and with greater accountability than other providers.

Federal policy over the past several years has dramatically increased the demand for child care for low income families but has done nothing to increase supply. Study after study provide critiques and recommendations for the rapidly growing field. However, few of these address the financial and capital needs of this asset-intensive business, and this is what H.R. 3637 will do. It is a welcome addition to the efforts to design a comprehensive system for parents who must or choose to take advantage of early childhood development programs for their children.

It is no surprise that child care programs for middle and low income families are experiencing even greater pressure as a result of the repeal of welfare. In the communities where this urgency exists, we do not have the supply of quality early childhood programs that middle and upper income communities take for granted.

According to the Illinois Department of Human Services, as of March 1, 1998, there were 530,000 recipients of Temporary Assistance to Needy Families (the program that replaced AFDC). Of these, 370,000 were children. The Illinois Facilities Fund projects that in the Chicago metropolitan area alone about 39,000 of these children will need full-day care within the next two years and will qualify for a child care subsidy. Of these families, 13,000 children are likely to select center-based care.[1] Illinois currently does not have child care programs to accommodate this projected demand. One example is in the Englewood neighborhood of Chicago, where 1,519 children under five are eligible for 161 child care spaces (including child care centers and licensed home providers). This community can only provide child care for 11 percent of the children needing care, even though these parents qualify for a subsidy and most will lose welfare benefits in the near future.

[1] The IFF uses conservative estimates based on current parent behavior, which indicates that between 32% and 38% of parents choose child care centers, and a majority of parents of children three and four years of age choose centers, according to The Future of Children: Financing Child Care (1996).

Child care is a highly regulated industry - both the building and the program of any child care center are subject to licensing, health and safety codes, and curriculum requirements. (Licensed homes also have regulations in Illinois.) Licensing covers staffing and square foot requirements. In order to obtain a license, the child care provider is required to make an up-front capital investment in buildings, supplies, playgrounds, and professional staff. Few child care providers with a mission to serve a mixed income community can make this investment, for reasons that are common to many small businesses and many nonprofit agencies, including a lack of collateral, low real estate values, and, most importantly, constrained revenues. However, the regulations are not causing problems of affordability. Personnel costs account for at least 80% of the costs of a typical child care center, and no one in the child care field believes that there are more staff than needed to provide quality programs.

Child care as a business cannot increase revenues to cover increased expenses without a very careful analysis of parent income and other choices available to parents. As a rule, child care providers work very hard to keep costs as low as possible. Their mission - whether for-profit or nonprofit - is to work with young children, and they want to remain in business.

Earlier this year President Clinton stated that he would like to subsidize child care for 1 million more low-income children, and increase Head Start by 350,000 children. The table below shows the projected capital costs associated with such a goal. In the table, it is assumed that only 32% of the children would use this subsidy in child care centers (see Footnote 1 on page 2):

Program	Additional children to be served in child care centers over five years	Additional classrooms needed	Additional square feet needed	Total cost over five years
Child Care Block Grant	320,000 children (32% of total)	16,000[2]	22.4 million[3]	$2.24 billion[4]
Head Start	350,000 Total • 270,000 three-to-five-year-olds • 80,000 Early Head Start children	20,588[5]	12.25 million[6]	$1.23 billion

Source: Illinois Facilities Fund

This table shows that for every additional dollar spent on the above programs, $0.31 in capital investment will be necessary to meet the increased demand, just from the parents who choose child care centers. We have not kept up with the need for capital investment in child care centers in the communities throughout the country where they are most needed.

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[2] Based on 20 children per classroom

[3] Assumes 70 square feet per child

[4] Assumes $100 per square foot for new construction. Source: The Future of Children: Financing Child Care. Vol. 6, No. 2, 1996.

[5] Based on 17 children per classroom. Assumes full-day

[6] Based on 35 square feet net usable space, per Head Start regulations.

Do we need a federal program to deal with this enormous need? Yes. H.R. 3637 is the first such broad effort. However, there are a number of barriers to financing that must be addressed as H.R. 3637 is designed and implemented.

Revenue limitation creates three distinct barriers to adequate market response to the growth of the child care field, particularly in middle and lower income communities. First, while government subsidies have increased overall, per child revenues have not increased and they are inadequate to spur investment or cover the true cost of quality care. Second, when child care providers want to respond to new demands, they still need to make a capital investment, or they spend a significant amount of time saving or raising the funds in order to undertake the facility project. Too often the immediate day to day needs win out over saving for a downpayment for a new facility. If successful in raising enough capital to launch the project, the low margins available for debt service determine the amount that can be borrowed. And finally, child care center buildings are special use buildings, decreasing their value to conventional lenders. As a result, lenders often require higher interest rates and greater debt coverage and loan to value ratios. H.R. 3637 will be able to address this problem directly.

These financing barriers have other implications and consequences for communities, families and children. The supply of center-based child care does not increase as demand increases, particularly in low-income neighborhoods. Intervention in this market is necessary, and this is the role that can be played by H.R. 3637.

Many banks are interested in community development lending, but in our experience in Illinois, even if debt service coverage requirements can be met through revenues, in most cases banks still require equity contributions of 20 percent and loan to value ratios based on appraisals. A sensible companion to H. R. 3637 would be an authorization to allow the states to use the Child Care Block Grant to provide equity grants to child care centers and programs in certain underserved communities. These projects would then be able to make use of bank lending, assuming they can generate enough revenue to cover debt.

In general I believe the guarantee amount proposed in H.R. 3637 should be used as a mechanism to stretch banks further in their loans to child care centers. I urge the Committee to provide guarantees based on terms proposed by banks, adjusting the level based on concessionary interest rates on the part of the bank. I also propose that special consideration be given to banks that work hard-to-make loans in low to moderate communities, so that H.R. 3637 is used to direct investment more equally throughout our communities.

SUMMARY

Despite wide recognition of child care as a valued service for parents and children, the field faces a constant lack of adequate resources to meet demand. This is largely because the costs of quality child care are more than what most parents will pay or are able to pay. The economics of the current child care field are built on keeping costs low.

The child care work force is the lowest paid work force in the country - in order to improve quality these salaries must be increased. H.R. 3637 is an opportunity to proactively address the issues of supply and related issues.